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SUBJECT: SCENESETTER FOR JULY 18-21 VISIT TO PARIS OF REUBEN JEFFERY, UNDER SECRETARY OF STATE FOR ECONOMIC, ENERGY AND AGRICULTURAL AFFAIRS

REF: PARIS 2643

¶1. (SBU) Summary: Your visit to Paris is an important early opportunity to engage with the Sarkozy government's economic team on a wide range of issues, as well as touch base with OECD and IEA leadership. You will be arriving in a France whose mood is up-beat for the first time in years. Sarkozy's energy and determination to meet challenges head-on and break with the past have lifted national morale. His resounding presidential victory May 6 -- notwithstanding the French electorate's decision in the June 17 legislative elections to bolster the Socialist opposition -- has given Sarkozy a broad-based mandate to undertake long overdue economic and social reforms. Sarkozy hopes that broad-based reforms -- from taxes and labor markets to university admissions -- will increase productivity, boost competitiveness and reduce France's chronically high unemployment rate (especially for youth). Although he may yet encounter popular resistance, the president is off to a fast start. We will watch closely to see how he reconciles his pro-market reform agenda with a more statist approach to issues that include industrial policy, EU competition policy, and proposals for a eurozone "economic government" to temper the ECB's focus on inflation-fighting. End Summary.

Sarkozy's Economic Agenda

¶2. (SBU) President Sarkozy has wasted little time in moving forward with a broad economic policy reform agenda. France's president has traditionally stayed above domestic issues and although Prime Minister Fillon officially presented the government's plan to the Parliament in early July, it is clear that it is Sarkozy who will manage many of the key dossiers in the new French government.

¶3. (SBU) Labor market reform, tax changes that encourage overtime work beyond the 35 hour work week, mortgage deductibility to encourage home homeownership, further pension reform, smaller government, the provision of minimum services during strikes and possible changes to France's collective bargaining system are highlights of the policy initiatives that are either underway, or in the offing. The outcome of this process could well determine whether the United States has a newly confident, dynamic, forward-looking economic partner in France.

¶4. (SBU) The Sarkozy government is also shaking up GOF economic policymaking structures. Following through on a campaign promise the president has created a "super ministry" of sustainable development by combining the former ministry of ecology with energy, transport and regional planning directorates hived off from other ministries. The goal in part is to internalize environmental and sustainable development concerns in policymaking, though it's too early to tell whether the change is having

its intended effect. Nevertheless it does signal that Sarkozy wants his government to focus on the nexus of environment ?- notably climate change -- and the global economy. Sarkozy signaled as much during his election night victory speech when he called on the United States "to take the lead" in the fight against global warming.

¶15. (SBU) Sarkozy welcomed President Bush's statement on a proposed new climate change framework in May, but he continues to advocate binding constraints on greenhouse gas emissions as a necessary ingredient of a post-2012 Kyoto follow-on agreement. He has also called for the imposition of a "carbon tax" on imports from countries that "do not respect environmental standards" as a means of defending Europe's CO2 emissions trading system (ETS). You can impress on your interlocutors U.S. interest in intensifying collaboration with France in developing climate-friendly energy technologies, in sharing approaches to energy efficiency, and by underscoring the dynamism of the private sector in attacking climate change.

¶16. (SBU) President Sarkozy has appointed as Economic and Finance Minister Christine Lagarde (former trade minister and previous chairman of Baker and McKenzie's Global Executive Committee), the first woman to hold this influential position in France. She is regarded as an advocate within the government for freer trade and is well-versed in the details of the transatlantic economic debate. But she is also an effective defender of French positions in the EU, and may have limited maneuvering room on the most sensitive issues given domestic political realities and the president's interest in keeping a firm hand on the economic policy tiller. Recently-named State Secretary for Enterprise and External Trade Herve Novelli will take on the day-to-day

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functions of trade minister, but we can assume that Lagarde would be closely engaged in any Doha end-game. The collapse of the G-4 process at Potsdam was seen as ?inevitable? by the French and there is no apparent urgency in Paris to close a Doha agreement.

¶17. (SBU) While keen on introducing market-friendly domestic reforms, Sarkozy is not shy about articulating a strong role for the state on French industrial and competition policy, and in promoting national or European "champions." As finance minister he helped to shape the French government's bailout of Alstom, and subsequently defended the policy before a critical European Commission. Sarkozy's advisors tell us the experience forged the president's view of EC policy on state aid and competition as being excessively dogmatic. Initial tests of industrial policy ? the pending merger of Gaz de France and Suez and a possible restructuring and increased state participation in Airbus mother company EADS ? may offer clues to how Sarkozy will manage such issues. We will watch closely to see whether the new government's policy evolves in a way that is harmful to the investment environment.

¶18. (SBU) Sarkozy has also made it plain (by attending the June 9 Eurogroup meeting of Finance Ministers) that he wants France ?- and member states generally -- to play a more active role in coordinating economic policy. To that end, Sarkozy has asked Minister of Finance Christine Lagarde to work with partners to create an "economic government" of Europe as a vehicle for engaging in dialogue with the ECB. Enjoying broad political support for his views at home, Sarkozy seems unperturbed by the criticism he's attracted elsewhere in Europe for his implied criticism of the ECB and euro exchange rate policy. Sarkozy's appearance at the July 9 Eurogroup finance ministers meeting also underlined his personal commitment to tax cuts that may help make France's economy more dynamic over the longer term, but that will push the target date for a balanced budget from 2010 to 2012.

¶19. (SBU) Although he received a tepid response in Brussels,

Sarkozy was more successful in arguing for the candidacy of former Socialist Minister of Finance Dominique Strauss-Kahn to become IMF Managing Director. The press - and an economic advisor to PM Francois Fillon - suggested the inspiration came from Luxembourg PM Jean-Claude Juncker, though the move clearly squares with Sarkozy's broader efforts to reach across domestic party lines and keep the socialist opposition off balance.

¶10. (SBU) On a host of other issues, ranging from efforts to curb WMD and terrorism financing to innovation, the Sarkozy government has indicated an interest and willingness to work closely with the United States. Your visit will be critical in helping to build relations with the Sarkozy team.

Background on OECD and IEA

¶11. (SBU) You will also have the opportunity to touch base with the OECD and IEA. At the recent OECD Ministerial Council Meeting (MCM) OECD Members agreed to strengthen the Organization's cooperation with Brazil, China, India, Indonesia and South Africa with a view to possible membership for those countries, and to open accession discussions with Chile, Estonia, Israel, the Russian Federation, and Slovenia. USOECD is working to arrange a meeting with the recently-appointed Secretary General, Angel Gurria, a former Mexican foreign

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affairs and finance minister. You will meet with Permanent Representatives from key OECD members, several of whom serve as chairs of important committees, to discuss enlargement, enhanced engagement, and the future of the Organization.

¶12. (SBU) The International Energy Agency (IEA), an independent organization under the administrative umbrella of the OECD, is in a period of transition. You will have the opportunity to meet with the outgoing Executive Director, Claude Mandil, as well as his successor, Nobuo Tanaka. Mandil has provided exemplary leadership during his tenure, excelling as a spokesman for the interests of the 26 member countries. Tanaka is a relative neophyte to international energy issues; his selection as the new Executive Director reflected the intensity of the Japanese Government's lobbying efforts. Your separate meetings with Mandil and Tanaka will likely cover common ground: (1) ensuring adequate resources for the IEA; (2) engaging key non-member countries, China, India, and Russia, more broadly and deeply; and (3) managing the G-8 work, particularly the Heiligendamm Process.

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